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Reflections on Public Interest Directors

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REFLECTIONS ON PUBLIC INTEREST DIRECTORS

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I. THE IDEA

The "public interest director" may not yet be an idea whose time has come, but it is an idea that can no longer be ignored. The time has come for responsible lawyers and other opinion leaders to know why, and to what extent, they favor or oppose it.

The most noticed articulation of the idea is, no doubt, that of Ralph Nader and his associates. The Nader group would require that each director have responsibility for a particular area of concern, such as employee welfare, consumer protection, and environmental protection.[1] Before the Nader manifesto appeared, Christopher Stone had advanced a more modest proposal whereby ten per cent of a company's directors would be designated to represent the public interest; in case of "demonstrated delinquency" in a particular area, such as consumer or environmental protection, a "special interest" director would be added for that area.[2] Still earlier, Cyril Moscow had advocated that each registered corporation should have one "independent" director appointed by the Securities and Exchange Commission.[3] All three proposals are directed to resolving the conflict between societal interests and corporate behavior that has troubled political and economic philosophers and has excited polemicists during the past half century.[4]

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1. R. NADER, M. GREEN & J. SELIGMAN, TAMING THE GIANT CORPORATION 125 (1976) [hereinafter cited as R. NADER]. A preliminary edition of the same work was published in 1975 under the title, CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR FEDERAL CHARTERING OF GIANT CORPORATIONS.

The three interests mentioned here are by no means a complete list of those with which Nader and Christopher Stone are concerned. Nader also specifically lists shareholder rights, compliance with law, finances, purchasing and marketing, management efficiency, and planning and research. I refer only to employee, consumer, and environmental interests partly for brevity and partly because these are the interests which seem to be most prominent among the concerns of all three proponents of public-interest directors.

2. C. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 152-83 (1975).

3. Moscow, *The Independent Director*, 28 BUS. LAW. 9, 11-12 (1972).

4. For more general advocacy of representation of public interests without much

For a conservative or middle-of-the-road thinker, and even for a liberal who values his objectivity, it is tempting to reject public-interest director proposals out of hand because of the intemperate denunciation of corporate management that accompanies some of them.[5] The rhetoric of Nader and Stone implies, although it may nowhere firmly assert, that corporate managers have been deliberately ripping off the public in a mad chase for exorbitant profits.[6] Careful observers are aware that many of the supposed sins against employees, consumers and the environment are, in fact, committed by enterprises that are clawing desperately for survival, managed by executives who would gladly accommodate public interest if they thought they could afford to.

But one does not need to believe that corporate profits are exorbitant, nor that executives are monomaniacal profit-seekers, in order to recognize that a majority of Americans are dissatisfied with contemporary conditions of work, of consumption, and of living. Their dissatisfactions are expressed in a torrent of labor laws, consumer product laws, and environmental laws. Since corporations provide most of the work, most of the consumer goods, and a good deal of the environmental deterioration,[7] they bear the brunt of regu-

specification of the structure, see R. DAHL, AFTER THE REVOLUTION? AUTHORITY IN A GOOD SOCIETY 115-40 (1970); Chayes, *The Modern Corporation and the Rule of Law*, in THE CORPORATION IN MODERN SOCIETY 25, 43-45 (E. Mason ed. 1960) [hereinafter cited as CORPORATION].

General critiques of this order of ideas may be found in N. JACOBY, CORPORATE POWER AND SOCIAL RESPONSIBILITY, 120-245 (1973); Blumberg, *Reflections on Proposals for Corporate Reform Through Change in the Composition of the Board of Directors: "Special Interest" or "Public" Directors*, 53 B.U.L. REV. 547 (1973); Ratner, *The Government of Business Corporations: Critical Reflections on the Rule of "One Share, One Vote,"* 56 CORNELL L. REV. 1, 31-38 (1970).

For a discussion of concern with corporate power and the interests which it serves, covering the last two centuries, see J. HURST, LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780-1970 (1970). For a nineteenth century response to those concerns, see W. COOK, THE CORPORATION PROBLEM (1891).

A general concern with the relation of corporate policies to societal objectives has been explored by Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); FUTURE OF THE CORPORATION (H. Kahn ed. 1973); A.S. MILLER, THE MODERN CORPORATE STATE: PRIVATE GOVERNMENTS AND THE AMERICAN CONSTITUTION (1976). Polemic attacks on corporations' antisocial behavior include R. HEILBRONER, M. MINTZ, C. MCCARTHY, S. UNGER, K. VANDIVIER, S. FRIEDMAN & J. BOYD, IN THE NAME OF PROFIT (1972), and I. WORMSER, FRANKENSTEIN, INC. (1931).

5. *See* Jacoby, *Federal Charters: A Flawed Case*, Wall St. J., Jan. 10, 1977, at 12, col. 6; Birdzell, Book Review, 32 BUS. LAW. 317 (1976).

6. *See* R. NADER, *supra* note 1, at 15-74; C. STONE, *supra* note 2, at 1-110. In contrast, Moscow, *supra* note 3, at 9, recognizes the same problems in more measured terms.

7. *See* P. BLUMBERG, THE MEGACORPORATION IN AMERICAN SOCIETY: THE SCOPE OF CORPORATE POWER 16-37 (1975).

latory legislation. The defenders of the modern corporation as well as its enemies should, therefore, be concerned with finding better ways to reconcile the conflicts between corporate and societal objectives. This essay explores one possible way.

II. Alternative Roads to the Modification of Corporate Behavior

If corporate behavior is to be modified, there are more ways than one to go about it. The institution of public interest directors must be compared with other means of attaining the same ends.

The most prevalent way of modifying corporate behavior for social ends is to legislate commands. The United States codes of laws and regulations are replete with rules on price practices, wage levels, safety devices, and emissions that exemplify this method.[8]

A second method of modifying corporate behavior is to strengthen the bargaining power of some of the people affected by its operations. The National Labor Relations Act[9] is a conspicuous device for strengthening employees' bargaining power through unions.[10] Another massive program for behavior modification through the exercise of bargaining power is the regime of securities regulation, which operates primarily by requiring disclosure of more information in order to protect investors.[11] The voluminous rules on labeling foods and drugs[12] and the requirement of list-price

8. Familiar examples are the Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (1970 & Supp. V 1975); the Robinson-Patman Price Discrimination Act, 15 U.S.C. §§ 13, 13a, 13b, 21a (1970); the Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201-219 (1970 & Supp. V 1975); the Walsh-Healey Act, 41 U.S.C. §§ 35-45 (1970) (prevailing wages in U.S. procurement contracts); the Bacon-Davis Act, 40 U.S.C. §§ 276a to 276a-5 (1970) (prevailing wages in U.S. construction); the Safety Appliance Acts, 45 U.S.C. §§ 1-43 (1970 & Supp. V 1975); the Occupational Safety and Health Act of 1970, 29 U.S.C. §§ 651-678 (1970); Air Pollution Control Act, 42 U.S.C. §§ 1857-1857(e) (1970 & Supp. V 1975); Federal Water Pollution Control Act, 33 U.S.C. §§ 1165a, 1251-1376 (1970 & Supp. V 1975).

9. Labor Management Relations Act of 1947, 29 U.S.C. §§ 141-188 (1970 & Supp. V 1975).

10. For an analysis of the effects of union bargaining power on corporate policies, see Chamberlain, *The Corporation and the Trade Union,* in Corporation, *supra* note 4, at 122.

11. Regulation is primarily through the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1970 & Supp. V 1975), and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1970 & Supp. V 1975). The acts will be cited herein as the "Securites Act" and the "Exchange Act," respectively.

See Levenson, *The Role of the SEC as a Consumer Protection Agency,* 27 Bus. Law. 61 (1971); Butowsky, *The Investment Company Act as "Consumer Legislation,"* 27 Bus. Law. 71 (1971); LeBlanc, *Accounting as a Consumer Protector,* 27 Bus. Law. 75 (1971); Sommer, *Random Thoughts on Disclosure as "Consumer" Protection,* 27 Bus. Law. 85 (1971).

12. Regulations for the enforcement of the Federal Food, Drug and Cosmetic

tickets on new cars[13] are further examples, adopted to increase the bargaining power of consumers. Unfortunately, no one has found a way to increase the bargaining power of the environment.

These well-known methods of behavior modification may be characterized as "external." Less familiar to our thinking are the "internal" methods of behavior modification, which work by molding the values of corporate executives and directors.[14]

One internal method of affecting corporate behavior is to make the managers responsible to holders of the interests that society wishes to protect. In the past, the only interests that society has so chosen to protect have been those of shareholders. Nearly all business corporation laws give lip service to this objective by requiring that directors be elected by shareholders,[15] and the Exchange Act honors it by the elaborate pageantry of the proxy rules.[16] Although these legislative designs can be easily nullified by resourceful counsel,[17] they are often allowed to operate as intended,[18] and they create

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Act and the Fair Packaging and Labeling Act are found in 21 C.F.R. §§ 1.1-.700 (1977); General Labeling Provisions (Drugs), 21 C.F.R. §§ 201.1-.19 (1977).

13. Automobile Information Disclosure Act, 15 U.S.C. §§ 1231-1233 (1970 & Supp. V 1975).

14. *Cf.* R. DAHL, *supra* note 4, at 121. Dahl classifies controls as "internal" (through the corporate structure), "governmental" (through positive rules of behavior), and "economic" (through market mechanisms).

15. *See, e.g.*, ABA-ALI MODEL BUS. CORP. ACT § 36 (1974); N.Y. BUS. CORP. LAW § 703 (McKinney 1963). Under Delaware law, shareholders' power to elect directors is not expressly stated, but it is implied by DEL. CODE tit. 8, § 141(d), 211(b) (1974 & Supp. 1976).

16. Regulation 14A: Solicitation of Proxies [under the Exchange Act], 17 C.F.R. §§ 240.14a-1 to .14a-12, 240.14a-101 to 14a-103 (1977).

17. The shareholder voting requirement is most frequently nullified by restricting the vote to a very small fraction of the shares. In the Green Giant Company, before its notorious reorganization, there were 44 shares of voting stock and 428,998 shares of nonvoting stock. *See* Honigman v. Green Giant Co., 309 F.2d 667, 669 (8th Cir. 1962). In the Ford Motor Company, before the Ford Foundation's public sale of its shares, 88 per cent of the shares were nonvoting. J. LIVINGSTON, THE AMERICAN STOCKHOLDER 147 (1963).

The proxy information requirements are nullified, at least in the largest corporations, by the fact that corporate executives are allowed to use company funds for the solicitation of proxies which they will use to elect their own bosses. Insurgent shareholders have no access to corporate funds for the all-important election of directors. *See* Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489 (1970).

For a general examination of the nonoperation of the "statutory norm" of corporate governance, see A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932); M. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS (1976); Hetherington, *Fact and Legal Theory: Shareholders, Managers and Social Responsibility*, 21 STAN. L. REV. 248 (1969).

18. *See* Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 40-44 (1969).

an illusion of shareholder control even when they are functionally inoperative. The public-interest-director proposals are designed to harness this somewhat unreliable structure for the protection of interests of employees, consumers, environmentalists, and others.

A second internal method of influencing corporate behavior is to indoctrinate corporate executives with a role conception that places a higher value on interests other than profit maximization. Most corporate decisions are irretrievably in the hands of the hierarchy of decisionmakers that John Kenneth Galbraith has dubbed "the technostructure."[19] These decisionmakers may have already mingled the goal of profit maximization with goals of their own choosing, such as perpetuating and aggrandizing the enterprise and their respective departments within it. They could probably add a solicitude for the interests of employees, consumers, and the environment without even being detected.

A socially oriented model of goals for enterprise managers was advocated in 1973 by a committee of the Confederation of British Industry, which declared:

> A company should behave like a good citizen in business. The law does not (and cannot) contain or prescribe the whole duty of a citizen. A good citizen takes account of the interests of others besides himself, and tries to exercise an informed and imaginative ethical judgment in deciding what he should and should not do. This, it is suggested, is how companies should seek to behave.
>
> Within its own field of knowledge, skill, geographical concern and financial capacity (these are important limitations) a company has the duty to be responsive to the movement of informed public opinion as well as to the requirements of authority. A company should, as is indeed the practice of the best companies, pay proper regard to the environmental and social consequences of its business activities, and should not sacrifice the safety or efficiency of goods and services in the interests of expediency and competitiveness. In environmental matters, it is usually the company that is the first to know of a potential hazard or critical situation; it has a duty in such circumstances not only to take all possible remedial measures but also to inform the responsible authorities.[20]

In the United States, a leading academic analyst of business management has declared:

> In an economic world that lacks the automatic regulation which the classical economists' concept of perfect competition was supposed to provide, the business executive must try to reconcile a range of partially conflicting goals—those of his stockholders, his workers,

19. J. GALBRAITH, THE NEW INDUSTRIAL STATE 79-83 (1967).

20. COMPANY AFFAIRS COMM., CONFEDERATION OF BRITISH INDUSTRY, THE RESPONSIBILITIES OF THE BRITISH PUBLIC COMPANY 23 (1973).

> his customers, his colleagues and himself, not to mention some vague conception of the public welfare as a whole. . . . In this welter of conflicting claims, it is not much exaggeration to say that the business leader has to play at being God.[21]

Similar views have been expressed occasionally by United States business leaders, usually speaking in their individual capacities.[22]

Various devices may be used to intensify directors' concern with the public interest aspects of their enterprise. Proposals like Nader's and Stone's may be useful means of affecting directors' scales of values, even if they never have any impact on corporate structure. Sensitivity would also be heightened by a requirement, as proposed in France, that companies report on how they are satisfying the interests of employees, consumers, and the environmentalists (as well as financial interests).[23] This would be quite different from the present SEC requirement, which compels disclosure only of effects of compliance with environmental rules upon the company's financial position.[24] The most effective sensitizer at the present time is the ever-impending threat of more rigorous regulation, which directors may seek to head off by responding to the demands of various sectors of the public.

If society has a choice between modifying corporate behavior by external or by internal means, it ought surely to choose the latter. When pressures are purely external, corporate managers may be presumed to comply with them as grudgingly as possible. Beverage bottlers may obstruct throw-away prohibitions by lobbying against legislation, obtaining injunctions against its enforcement, repurchasing containers at inconvenient times and places, and delaying or deceiving inspectors. Manufacturers may comply with antinoise rules

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21. R. GORDON, BUSINESS LEADERSHIP IN THE LARGE CORPORATION xvi (rev. ed. 1961).

22. *See* R. BAUER, THE CORPORATE SOCIAL AUDIT iii, 3-8 (Social Science Frontiers No. 5, 1972); D. MACNAUGHTON, MANAGING SOCIAL RESPONSIVENESS (1975) (distributed by Prudential Insurance Company); BLUMBERG, *supra* note 7, at 4-6.

23. *See* the proposal for an annual company report on a "social balance sheet" advanced in COMITÉ D'ÉTUDE POUR LA RÉFORME DE L'ENTREPRISE, LA RÉFORME DE L'ENTERPRISE 204 (1975); *Le "bilan social" dans les rapports des sociétés cotées pour 1975*, BULLETIN MENSUEL DE LA COMMISSION DES OPERATIONS DE BOURSE, December 1976, at 7-8.

24. "Thè amendments adopted herewith will require as a part of the description of an issuer's business, appropriate disclosure with respect to the material effects which compliance with environmental laws and regulations may have upon the capital expenditures, earnings and competitive position of the issuer and its subsidiaries." SEC Securities Exchange Act Release No. 10116 and SEC Securities Act Release No. 5386 (April 20, 1973), 38 Fed. Reg. 12100, *reprinted in* [1974] 2 FED. SEC. L. REP. (CCH) ¶ 23,507A (1974).

in ways that meet a statutory standard with the minimum permissible benefit to workers.

Furthermore, external pressures imposed on resistant enterprises may result in deadlocks that can cause immense losses to everyone involved, as when workers strike for higher wages or manufacturers strike (by refusing to produce conforming products) against emission standards. Such deadlocks may result from mistaken estimates by one side or the other about what is technically or economically feasible. Wage demands may push enterprises into bankruptcy instead of raising incomes, and emissions regulations may close down paper mills and power plants, rather than achieving amelioration.

If, on the other hand, boards of directors would be so constituted that they would spontaneously direct their efforts toward conferring the maximum feasible benefits on employees, consumers and the environment, accommodation of conflicting goals might be achieved after long study and debate, but without strikes, obstruction, deceit, and litigation.

This is the dream of the advocates of public-interest directors. The question to be considered is, to what extent is it achievable?

III. Redefining Directors' Duties

If officers and directors are to give weight in their decisions to the interests of employees, consumers and the environment, an essential preliminary task is to redefine their legal obligations. It would be a cruel hoax to appoint directors with a mandate to sacrifice shareholders' interests in favor of those of consumers, and then to hold them liable for damages because they have violated their duty to the corporation. But this could occur if public interest directors were appointed without changing the law of directors' duties. Unfortunately, the reformers' writings have given little attention to the solution of this problem.[25]

Since company managers have seldom admitted sacrificing shareholders' interests to other considerations, courts have had little occasion to modify ancient dogma on this subject. The leading case is still that of *Dodge v. Ford Motor Company*,[26] decided in 1919, in which Henry Ford was admonished by the Supreme Court of Michigan that his professed objectives of benefiting his employees and consumers were a misconception of his duties.[27] Although the

25. The problem is explored in Rostow, *To Whom and for What End Is Corporate Management Responsible?*, in Corporation, *supra* note 4, at 46.

26. 204 Mich. 459, 170 N.W. 668 (1919).

27. 204 Mich. at 507, 170 N.W. at 684.

court refrained from any fundamental interference with company policies, it did so only because the judges suspected (with good reason) that some long-term profit objectives lay behind the short-term sacrifices.[28] Even so, the court ordered him to distribute $19 million of excess cash.[29]

In later cases, judges have tolerated charitable gifts that were implausibly rationalized as furthering corporate interests, but they have not otherwise retreated from the doctrine that the duty of directors is to benefit the company investors.[30] Corporation laws have been amended to permit charitable gifts in limited amounts, but they still do not authorize charitable policies toward profitmaking.[31] If directors were chosen for the express purpose of representing other interests in corporate policies, they would find themselves caught in a very uncomfortable crossfire between their legal duty to the corporation and the purpose of their election.

A simplistic solution to the difficulty would be to declare that directors are bound to direct the company for the most desirable accommodation of interests of investors, employees, consumers and the environment. To be fair, one should probably add some other interests not often mentioned by the reformers—those of creditors, vendors, immediate customers (who are generally different from the ultimate consumers),[32] the national economy, and public order.

The only known experience with such a multipurpose mandate is not illuminating. The German Corporation Law of 1937 commanded company officers to manage in the interests of the enterprise, the personnel, and the common wealth of the people and the state.[33] This formulation was dropped without explanation in the

28. "We are not satisfied that the alleged motives of the directors, in so far as they are reflected in the conduct of the business, menace the interests of shareholders." 204 Mich. at 508, 170 N.W. at 684.

Ford's reductions in price and in dividends, which he attributed to altruistic reasons, had the incidental effect of reducing the resources which his dividends provided to the Dodge Brothers, who had begun to compete with him, thus making competition more difficult. *See* L. SELTZER, A FINANCIAL HISTORY OF THE AMERICAN AUTOMOBILE INDUSTRY 240 (1973).

29. 204 Mich. at 487, 510, 170 N.W. at 677, 685.

30. 39 CORNELL L.Q. 122 (1953).

31. *See* ABA-ALI MODEL BUS. CORP. ACT § 4(m) (1974). For a tabulation of states with similar provisions, see 1 MODEL BUS. CORP. ACT ANN. § 1, ¶¶ 3.01-.02 (2d ed. 1971). A leading case under one such statute is A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581 (1953).

32. In basic industries like coal and steel, ultimate consumers such as railroad and automobile passengers are far removed from producers. Even in consumer goods industries, the consumers are usually separated from producers by one or two tiers of distributors.

33. Law on Negotiable Share Companies (*Gesetz über Aktiengesellschaften und*

law revision of 1965, which simply ordered managers to manage the company.[34]

A dual statement of objectives is contained in the proposed statute for "European companies" to be chartered by the European Economic Community, which would command managers to "promote the interests of the company and its personnel."[35] This dual formula, like the simplistic solution proposed above, suggests some puzzling problems about enforcement. Could employees sue to enjoin the officers from unduly favoring the company over the personnel, while shareholders would sue for the reverse bias? If this were possible a whole series of management decisions might be thrust upon the judges.

A possible solution to this difficulty is suggested by the proposal of the British Conservative government, made shortly before its displacement by the Labour Party, that "companies should consider adding to their memoranda a clause *allowing* directors to take wider considerations into account."[36] This kind of an authorization would *permit* managers to justify action that favored employees or consumers, without creating a basis for complaint if they did not. The only misconduct that courts could redress would be directors' actions favoring the directors themselves or negligent actions favoring no one.

A statute drafted along these lines would be a radical departure from current legal doctrine in the United States, but it would probably make little difference in the decisions of cases. Practically all the cases in which courts interfere with management decisions are those in which the managers have favored themselves or a controlling group. The formulation would correspond to the public pronouncements of many corporate leaders, who proclaim their beneficence toward their employees and the public.[37]

Kommanditgesellschaften auf Aktien) of Jan. 30, 1937, [1937] Reichsgesetzblatt [RGBl] § 70,588 (Ger.). The closing words of the formula—*Volk und Reich*—were bywords of the National Socialist movement.

34. Law on Negotiable Share Companies (*Aktiengesetz*) of Sept. 6, 1965, Bundesgesetzblatt, Teil I, pt. 2 [BGB III] §§ 76(1), 93(1) (1965) (W. Ger.).

35. Statute for European Companies (1975), art. 70(1), BULL. EUR. COMM. (Supp. 4/75), at 41. The statute is designed to permit the formation of corporations within the European Economic Community which would be subject only to rules of the Community, rather than those of any one member state. *See* Vagts & Welde, *The Societa Europaea: A Future Option to U.S. Corporations?*, 29 BUS. LAW. 823 (1974).

36. DEPT. OF TRADE AND INDUSTRY, COMPANY LAW REFORM 19-20 (1973) (emphasis added). The report ascribed the proposal to the "Watkinson Committee" report, but it is not clear that the report intended to be merely permissive about broader responsibilities. *See* COMPANY AFFAIRS COMM., *supra* note 20, at 9.

37. *See* R. BAUER, *supra* note 22; D. MACNAUGHTON, *supra* note 22.

IV. The Difficulties of Multipurpose Management

To most executives, the vision of a board of directors composed of advocates of competing objectives would be a nightmare. Even when all the board members are devoted to the single object of maximizing corporate profits, there are problems enough in reaching prompt decisions and following consistent policies. The thought of directors with different and conflicting objectives evokes memories of the coalition governments of the German Weimar Republic and the French Third Republic.

This nightmare might well become a reality if multipurpose directors attempted to follow the traditional statutory norm which states that "the business and affairs of a corporation shall be managed by a board of directors."[38] But this precept has never been taken seriously. Corporations have often employed the statutory option of delegating many areas of decisionmaking to executive committees.[39] Even when they did not, the important decisions were usually made by executives and ritualistically ratified by the full board.[40] The precept itself has recently been modified by an amendment of the Model Business Corporation Act to provide that the business shall be managed "under the direction" of the board.[41]

The delegation of management functions to executives and executive committees may alleviate the problems of conflict in a multipurpose board, but probably would not eliminate the danger of destructive conflict, because the delegation would always be revocable and subject to being overruled. A more complete system

38. ABA-ALI Model Bus. Corp. Act § 35 (1969) contained this formulation before its amendment in 1974 to prescribe management "under the direction of" the board. *See* ALI-ABA Model Bus. Corp. Act § 35 (1974). Delaware General Corporation Law was similar before it was amended in the same year. *See* Del. Code tit. 8, § 141 (1974) (amended 1974).

39. Statutory authorization for the delegation is found, for example, in Del. Code tit. 8, § 141(c) (Cum. Supp. 1976); ABA-ALI Model Bus. Corp. Act § 42 (1974). On the use of executive committees, see C. Brown, Putting the Corporate Board To Work 66-69 (1976); The Conference Board, Corporate Directorship Practices: Membership and Committees of the Board 50 (1973); The Conference Board, Corporate Directorship Practices: Role, Selection and Legal Status of the Board 109-17 (1973).

40. *See* M. Mace, Directors: Myth and Reality 11-13 (1972); R. Gordon, Business Leadership in the Large Corporation 116-46 (1961).

41. *See* note 38 *supra*. The Delaware amendments state that business shall be managed "by or under the direction of" the board. Del. Code tit. 8, § 141(a) (Cum. Supp. 1976). For comment on the amendments, see Model Bus. Corp. Act Ann. § 1, 142 (2d ed. 1971); *Report of the Committee on Corporate Laws: Changes in the Model Business Corporation Act*, 30 Bus. Law. 501 (1975); Arsht & Black, *Analysis of the 1974 Amendments to the Delaware Corporation Law*, in 2 Corporation (P-H) 375, 376 (1974).

for separating the function of management from the more deliberative function of supervision is the European two-tier system, which divides corporate governance between a managing board of executives and a supervisory board of nonexecutives, including outsiders.[42] The supervisory board appoints the members of the managing board but is forbidden to interfere in management functions. This system was adopted by Germany in 1937,[43] by France (as an optional variation) in 1966,[44] and by The Netherlands in 1971.[45] It is currently contained in draft legislation of the European Economic Community which, if adopted, would be mandatory for all nine members of the community.[46] Although observers differ on the merits of the two-tier system,[47] its growing list of adherents in Western Europe indicates that it has won widespread approval among those who have seen it in action.

A simpler method of separating management from supervision has been suggested by Courtney Brown, who would merely remove all or most of the executives from the board.[48] But this proposal has the disadvantage of eliminating any requirement of group action at the executive level. Probably there is merit in the concept of shared executive responsibility,[49] as embodied in both the traditional executive committees of American corporations and the "managing boards" of the European systems.[50]

If representatives of conflicting interests are to enter the governing structure of corporations, they should be restricted to supervisory boards from which management functions have been separated. The executives, constituting the executive committee or managing board, would be chosen to work together as a team in running the company.

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42. Vagts, *The European System*, 27 BUS. LAW. 165 (1972); Schoenbaum & Lieser, *Reform of the Structure of the American Corporation: The "Two-Tier" Board Model*, 62 KY. L.J. 91 (1973).

43. RGB*l* §§ 70-99, BGB III §§ 76-116.

44. Law on Commercial Companies (*Loi sur les sociétés commerciales*) No. 66-537 of July 24, 1966, arts. 118-150, in CCH, FRENCH LAW ON COMMERCIAL COMPANIES 72 (1971).

45. Wetboek van Koophandel [W. v.K.] arts. 52c-52n (Neth.).

46. COMMISSION OF THE EUROPEAN COMMUNITIES, PROPOSAL FOR A FIFTH DIRECTIVE ON THE STRUCTURE OF SOCIÉTÉS ANONYMES, (BULL. EUR. COMM. (Supp. 10/72)). The directive would apply only to companies with freely negotiable shares, and not to "close corporations."

47. *See, e.g.*, Vagts, *supra* note 42; Schoenbaum & Lieser, *supra* note 42; Roth, *Supervision of Corporate Management: The "Outside" Director and the German Experience*, 51 N.C.L. REV. 1369 (1973).

48. C. BROWN, *supra* note 39, at 32-33.

49. *See* M. MACE, *supra* note 40, at 13-27.

50. *See* R. GORDON, *supra* note 40, at 99-115.

The representatives of conflicting interests would debate and compromise their differences in the relative isolation of an audit committee, a supervisory board, or a board of nonexecutive directors. The omission of a provision for any such separation of functions appears to be a major flaw in the proposals of Nader and Stone.

V. The Problems of Multipurpose Supervision

Even if the management function is separated from the board of directors, there remain problems in effective supervision by a board with diverse objectives.[51] To visualize the problem in its most acute form, one may imagine a public health representative on the board of a tobacco company, a wilderness representative on the board of a lumber company, and a zero-growth advocate on the board of a cement manufacturer. Although all these representatives have legitimate concerns, they cannot be effective on the board of a company whose whole program they oppose. To the extent that they are loyal to their own constituencies, they must favor the failure of the enterprise rather than its success. On the rare occasions where their interests coincide with those of other board members, their voices will be distrusted because of their known hostility to the objectives of the enterprise.

Although this problem inheres in all board memberships for "public interest" purposes, its intensity varies greatly among the several constituencies that board members may represent. It is least inherent in the representation of employees. In common with investors, customers and consumers, employees stand to gain from efficiency and economy in management, and they are uniquely situated to apprise investors of executive inefficiency and executive self-serving. In common with investors and with managers as well (although not with customers and consumers), employees have an interest in maximizing the prices obtained for products, not only for the present but also for the long-term future. Finally, in common with managers, they have an interest in the continuation of the enterprise, in contrast to speculative investors who may favor a stripping operation; giving employees a few seats on the board might be an effective way of dealing with corporate "raiders."

This view of employee interests may appear inconsistent with the stance frequently taken by labor union leaders. But the apparent hostility of labor leaders to enterprise prosperity is partly, at least, a product of the warlike charade characteristic of the "collective bar-

51. *See* N. Jacoby, *supra* note 4, at 173-74.

gaining" process, in which workers must be constantly inspired with enough hostility to mount a strike in order to back up their bargaining representatives.

Employee representatives on a board might work very differently. As members of a board rather than bargaining agents, they would find that their success would depend on their ability to persuade the representatives of investors that their interests converge, instead of on their power to bring on a common disaster. Furthermore, each board would include representatives of the nonunionized employees as well as of the unionized; if the German pattern were followed, the white-collar employees would vote separately from the blue-collar.[52] In The Netherlands, the "employee representatives" are not elected directly by the employees but are co-opted by the existing board, subject to rejection by votes of employees. The German experience, covering a quarter of a century, indicates that employee representation can work for the prosperity of enterprise, or at least without adverse effect.[53]

There is, of course, one area in which employee interests are inherently contrary to those of other constituencies—not only investors, but also customers, consumers and others. Employees will want more pay, and representatives of other interests will want to give them less. But if employee representatives are less than a majority of the full board, representatives of other interests can be relied on to back up the managers' resistance to excessive labor demands.

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52. Codetermination Act (Mitbestimmungsgesetz) of May 4, 1976, [1976] Bundesgesetzblatt [BGB*l*] I § 10, 1153 (W. Ger.). Furthermore, the representatives must include representatives of white-collar employees and supervisory employees (foremen, managers and executives) as well as of blue-collar workers.

The distinction between *Arbeiter* and *Angestellten,* which are rendered here as "white collar" and "blue collar" employees, depends on a complex series of criteria set forth in the German social insurance law. A German commentator says it is chiefly a distinction between hand-workers and head-workers. H. MEILICKE & W. MEILICKE, KOMMENTAR ZUM MITBESTIMMUNGSGESETZ 1976, at 62 (1976) [hereinafter cited as MEILICKE].

In the enterprises which are still governed by the Enterprise Structure Law of 1952, the classes of workers are not required to vote separately, but the law requires that the employee representatives include a white-collar worker. Enterprise Structure Act (Betriebsverfassungsgesetz) of Oct. 11, 1952, [1952] Bundesgesetzblatt [BGB*l*] I § 76(2), 681 (W. Ger.).

53. Blumberg, Goldston & Gibson, *Corporate Social Responsibility Panel: The Constituencies of the Corporation and the Role of the Institutional Investor,* 28 BUS. LAW. 177 (1973); Simitis, *Workers' Participation in the Enterprise—Transcending Company Law?,* 38 MOD. L. REV. 1, 9-10 (1975).

A multipartite commission to study codetermination, appointed by the West German Chancellor in 1966, reported in 1970. Their report, SACHVERSTÄNDIGENKOMMISSION, MITBESTIMMUNG IM UNTERNEHMEN (1970), contains a generally favorable account of the operations of codetermination. *Id.* at 54-98. The report is known as the "Biedenkopf Report," after its chairman.

The coincidence of employee interests with the interests of other enterprise constituents varies widely with the degree of employee dependence on the enterprise. In an enterprise that consists of a single retail store or restaurant, the individual salesman or waiter does not need to be greatly concerned with the survival of the enterprise; he can work as well for whoever absorbs the business after the enterprise fails. In contrast, the employees of General Motors in Flint or of U.S. Steel in Gary would face catastrophic dislocations if their employers collapsed. Among the factors that affect the degree of dependence, one of the most easily identified is the size of the work force. There is therefore sense in the German rules that invoke representation only in corporations with a work force of 500 or more.[54]

Another enterprise group whose interests are highly identified with the prosperity of the enterprise are the customers—those who buy its products or services. For a public utility—a railroad, an electric power company or a telephone company—the customers are also the consumers. Because of the monopolistic character of these industries, their customers are intimately concerned with the prosperity of the enterprise that serves them; the failure of Penn Central menaced its shippers much more than its investors, most of whom must have had well-diversified portfolios. Furthermore, the customers of a monopoly have very little ability to protect themselves through the exercise of bargaining power.

The franchised distributors of automobiles bear a relation to automobile manufacturers somewhat like that of customers to a public utility; they are deeply involved in the manufacturer's success, and their interests concur with those of investors and employees except in the price which they must pay for their purchases. Their representatives might be expected to work effectively with investor representatives on a supervisory board. Like employees, they could probably contribute unique perspectives in considering how well the business is being run.

Ultimate consumers are usually several steps lower on the scale of commonality of interests. The prosperity of any particular manufacturer is of little concern to them; their "customer loyalty" readily

54. This threshold was set by the Enterprise Structure Law of Oct. 11, 1952, [1952] BGB*l* I 681. However, the provisions of this act were superseded as to enterprises with 2000 or more employees by the Codetermination Act of 1976, [1976] BGB*l* I 1153. As a result, West Germany has one regime of employee participation for enterprises with 500 to 2000 workers, and another more rigorous one for enterprises with 2000 or more. There is also a third regime for coal and steel enterprises, which is ignored, for simplicity, in this discussion.

gives way to offers of a larger rebate on a competing brand. The likelihood that their representatives will contribute much to the joint concerns of a multipurpose board of directors seems small. Even so, their chances of effective cooperation with investors are probably better than those of environmentalists.

Still further removed from the interests of the enterprise are those persons concerned with the effect of the enterprise on the environment. The farmers who receive the fallout from Gary's blast furnaces and Butte's copper smelters may have no interest in the companies involved except to see them disappear.

VI. The Selection of Representatives

Representation of the interests of employees, consumers and the environment is not likely to achieve much unless the employees, the consumers and the environmentalists actually believe that their interests are being effectively represented. If the representatives do not have the confidence of their constituents, they will not have much influence on the representatives of other interests, and they will not allay the frustration felt by those sectors of the public. The constituents are unlikely to place that confidence in their representatives unless they have some role in electing them.

Of all the public interest constituencies, the employees are the best equipped to choose their own representatives. Their names and addresses are accessible, and they have ready access to one another. The two principal dangers to be avoided would be domination of representatives by the company's executives and domination by labor union leaders. To guard against dominance by the executive, it would be sufficient to require the company to finance at a reasonable level the nomination and campaign activies of employee groups. To guard against dominance by labor leaders, it would be sufficient to divide the employees for voting purposes into categories such as manual, clerical and supervisory, with each group having its own representatives, and to forbid the use of union funds in employee elections.

Selection of representatives by customers would present a more varied set of problems.[55] It would be most practicable in power, gas and telephone companies, where the customers' names and addresses and volume of business are already known to the companies. In retail merchandising companies, on the other hand, voting by customers would hardly be feasible, even if such a selection process

55. *See* Ratner, *supra* note 4, at 32-33.

were not, as previously indicated, of doubtful value because of the lack of common interests between customers and other constituencies.

In contrast to employees and customers, ultimate consumers and environmentalists seem to be inherently unsuitable as electorates. Even the most outspoken advocates of their interests—such as Nader and Stone—have refrained from proposing that they be given a role in director selection.

Recognizing the difficulties of using public interest constituencies as electorates, the principal advocates of public interest directors have proposed other methods of selection. Nader would have them elected by the shareholders;[56] he would overcome their traditional passivity by various provisions for minority nomination and by requiring institutional investors to pass voting powers through to their own shareholders.[57] This plan seems to be misguided in at least two respects. First, it ignores the demonstrated fact that most investors will not take the time to study issues in corporate elections, even when they hold shares directly. When they have invested through institutions, they have already made up their minds to delegate their decisionmaking to others. Even if shareholders could be persuaded to participate, they would be more likely to demand higher dividends than to support social interests. Second, Nader ignores the fact that no one would have any reason to regard the shareholders' choices as reliable spokesmen for employees, consumers, or environmentalists.

The Stone and Moscow plans are somewhat more plausible, in that both call for the major role in nomination to be played by independent organizations, including governmental commissions.[58] Their proposals have the merit of assuring that the directors so chosen would be independent of the executives, but they give no assurance that these directors would be significantly closer to employees, consumers and environmentalists. Whether they would effectively serve public interests is an interesting speculation. Government representatives sit on the boards of many British and Italian corpora-

56. R. NADER, *supra* note 1, at 126-28.

57. *Id.* at 126-30.

58. Stone proposes that public interest directors be appointed by a new Federal Corporations Commission or, in its absence, by the SEC. C. STONE, *supra* note 2, at 159. Moscow leaves election to the shareholders, but limits the nominees to those approved by a new agency supervised by the SEC which would receive proposals from such national organizations as the American Institute of Certified Public Accountants, as well as bankers, lawyers, public accountants, university professors and others. Moscow, *supra* note 3, at 12.

tions and of the German Volkswagen corporation by reason of governmental ownership of shares. One may reasonably expect that these directors, like ambassadors to foreign countries, would be obeisant to their appointing agencies and would confine themselves to repeating faithfully the pronouncements of their principals in the District of Columbia. As a result, they might represent very poorly the interests that they are designed to protect and would instead merely supply jobs for a new bureaucracy. The SEC's reluctant implementation of the requirements of the Environmental Protection Act warn against relying on governmental appointees to achieve social objectives.[59]

Whether these untoward consequences would eventuate cannot be known without actual experience. Reasonable inferences could be drawn from observation of experience with government representatives on boards in European countries. There is also a small amount of experience available in the United States. Stone has analyzed, with inconclusive results, the experiment with a United States government director on the Union Pacific Railroad Company.[60] There have also been numerous government directors on the boards of companies whose shares were seized as enemy property under the Trading with the Enemy Act,[61] but the present writer is not aware of any analysis of the roles that these directors played.[62]

VII. Political and Constitutional Practicability

In considering how various structural revisions of corporate governance might work in practice, I have passed over the question whether political and legal forces would permit or preclude their adoption in the United States. This question is left for another day, partly to spare time and space, and partly because I believe that all the ideas advanced in this essay will require long exposure to public discussion before they will be suitable subjects for legislation.

For those who may wish to pursue further the development of these ideas, I will point to two areas of difficulty that seem to merit

59. *See* Natural Resources Defense Council, Inc. v. SEC, 389 F. Supp. 689 (D.D.C. 1974).

60. C. Stone, *supra* note 2, at 153-58.

61. *See* Fallon, *Enemy Business Enterprises and the Alien Property Custodian,* 15 Fordham L. Rev. 222 (1946), 16 Fordham L. Rev. 55 (1947).

62. The writer was briefly associated with the Office of General Counsel for the Alien Property Custodian (1945-1946), and is of the impression that government directors were principally concerned with assuring themselves that the companies were being run for the purpose of profit rather than for the furtherance of enemy political objectives.

particular attention—the political and the constitutional. On the political side, the main obstacle is the absence of any active desire for the implementation of these ideas on the part of the most eligible participants—employees and customers. With regard to employees, there seems to be a basic rivalry between the internal system of representation within the company structure and the system of collective bargaining. If internal representation should prove effective, union officers would lose their role of leaders-in-battle, on which much of their power and prestige depends. Consequently, union officers seem likely to oppose "codetermination," even if it would, in the opinion of impartial observers, serve the best interests of workers. Employees will be slow to perceive the conflict between their own interests and those of their elected leaders.

With regard to customers, there does not seem to be any organizational obstacle to representation, but simply a lack of any strong motivation to support it. The traditional defensive tactic of customers has been to seek legislative action; shippers have obtained railroad regulation, electric customers have obtained utility regulation, and automobile dealers have obtained a degree of regulation over manufacturers' treatment of distributors. Since the largest customers have customers of their own, their executives are likely to hesitate to espouse a principle that might undermine their own authority.

Turning to the constitutional problem, an interesting question is presented regarding the constitutional basis for giving votes to new voices among the corporate constituencies. The proposal is reminiscent of the *Dartmouth College* case,[63] in which the State of New Hampshire attempted to place its own representatives on the board of overseers of the college. The particular constitutional objection that prevailed there—the prohibition on impairment of contracts[64]—would not stand in the way of federal legislation,[65] but obstacles might be found in the clauses on due process and on taking property without compensation.[66] Perhaps the state would have to compensate shareholders for taking some part of their bundle of rights by taking away a part of the voting power in the corporation. A similar question was raised in Germany with the Codetermination Act of 1976, and various opinions on it were expressed both before and

63. Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819).

64. U.S. CONST. art. I, § 10, cl. 1.

65. The impairment-of-contracts clause, U.S. CONST. art I, § 10, cl. 1, is a limitation on the states, but not on Congress.

66. U.S. CONST. amend. V.

after its enactment.[67] At this writing, the question has not been resolved by the West German Constitutional Court.

VIII. CONCLUSION

Putting together the pieces of the puzzle, we can draw some plausible conclusions about various kinds of public interest directors.

Environmental interest directors are the least likely to be useful, even to environmentalists. Since defenders of the environment have few interests in common with representatives of investors, employees, customers, or consumers, they have little chance of making effective alliances with other constituencies. Having no constituency within the ambit of corporate operations, they have nothing to trade off. Although they might serve as gadflies, their energies would be more productively spent in the political arena, where their influence over voters gives them a position of greater strength. Their presence on corporate boards may even be detrimental to the environmental cause, for such presence might nourish the supposition that environmental interests are fairly weighed inside the corporation, which can never be true because of the weight of the interests arrayed against them.

Consumer interest directors have a slightly better chance of operating effectively, because the other corporate constituencies—investors, employees, and customers—have a lively interest in consumer favor. But there are two obstacles for which no solutions have been suggested. One is the difficulty of finding the consumers and persuading them to concern themselves with their representation. The other is that if the consumers speak their minds, their minds may be devoid of any real concern for the prosperity and continuity of the enterprise. The mind of the consumer is usually on the marketplace where he pays the price for the product. Consumer interests are likely to be better served by improving their access to information, suppressing restraints on competition, and invoking criminal laws against purveyors of dangerous or fraudulent products.

On the other hand, customer-interest directors and employee-interest directors seem to be structurally practicable. In the giant enterprises that are envisioned in all discussions of public interest directors, it will usually be possible to identify and mobilize the constituencies involved. Both customers and employees have an inter-

67. *See* MEILICKE, *supra* note 52, at 44-47; T. RAISER, GRUNDGESETZ UND PARITÄTISCHE MITBESTIMMIUNG (1975); Meissel & Fogel, *Co-Determination in Germany: Labor's Participation in Management*, 9 INTL. LAW. 190 (1975).

est in the long-term welfare of the enterprise even greater than that of many shareholders, who can switch their loyalties as fast as they can dial Merrill Lynch. Employees and customers are much less likely than investors to display the apathy toward corporate affairs that has turned shareholders' meetings into empty charades.

The danger in a system of governance shared by the representatives of employees, customers and investors is not so much that it would not work as that it would work too well. The normal impulse of investors to hold down wage costs and maximize sales might give way to conspiracies to provide higher wages, more restricted outlets, and higher profits, all at the expense of consumers. But this outcome seems no more likely to take place when employees and customers are represented in governance than when they are not. If employees and customers were represented, the former would have a chance to influence marketing in a direction that would maximize employment, and the latter would have an opportunity to influence wage policy in the direction of minimizing prices. The tendency of these constituencies to balance one another would depend in large part on the competitiveness of the industry. Representation of employees and customers might make rigorous competition even more essential to public welfare than it is today.

The conclusions to which I am driven by these reflections may be disappointing, but they are not without their positive aspects. With respect to environmental interests, they reinforce the view of leading environmental spokesmen that their influence on enterprises must be exercised through the external pressures of regulations and law suits.[68] A secondary line of defense must be education of public opinion to induce investors, employees, customers, and consumers to use their votes and their bargaining power on behalf of environmental interests.

Consumer interests are also unlikely to get much help from direct representation in the corporate structure. They must rely on a combination of government regulation with the power of consumers to make choices in the open market. But consumers would probably get some indirect help from the representation of customers and employees. Customer representation will benefit consumers when it exerts its influence for a better product at a lower price. Employee representation will benefit consumers when it reduces the wasteful antagonism between employers and employees.

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68. J. SAX, DEFENDING THE ENVIRONMENT 175-230 (1971); *cf.* Heyman, Quarles, Sive & Cutler, *The Challenge of Environmental Controls*, 28 BUS. LAW. 9 (1973).

Customers' interests, in contrast to consumers', could be effectively advanced through changes in the corporate structure, and the consequences would probably be beneficial to ultimate consumers.

Employees' interests could very readily be advanced through corporate structure. Although use of this channel would probably not result in higher wages than they can get by collective bargaining, it might well operate to advance their welfare through more harmonious industrial relations. It could also benefit consumers and diminish the bitterness of the class struggle.

If none of these forms of public interest representation are put into effect, it will not follow that the proposals have been in vain. Although their proponents have failed to modify corporation behavior through structural change, they may modify it through the second "internal method"—the reshaping of officers' and directors' conceptions of their social roles. Probably all directors like to think of themselves, in some degree, as actors in the public interest, and the discussion of special directors for employees, consumers and environmentalists will make ordinary directors a little more cognizant and considerate of nonprofit objectives.

More important than the effects of the public discussion of multiple societal objectives on directors will be its effects on the role conceptions of corporate executives. Regardless of who may be directors, enterprises are increasingly under the control of the technicians who run them. This is partly because of the immense size of enterprises, but even more because of the technical character of the information on which decisions must be made. If public opinion calls for a greater sensitivity to community interests, and even more if it mumbles a threat to saddle executives with a new crew of militant public-interest overseers, executives will bring about decisions that tend to mollify the advocates of these public interests.